THE DEMAND FOR PUBLIC JUDICIAL REVIEW IN PRIVATE DISPUTE RESOLUTION: HOW TO OBTAIN IT

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(published in February 2005)

THE FINALITY OF ARBITRATION – THE GOOD NEWS AND THE BAD NEWS

Arbitration and other methods of dispute resolution have significant advantages for businesses that are interested in resolving disputes in a manner that is faster, cheaper and more confidential than traditional litigation. Although many consumers of dispute resolution services have questions about the extent to which arbitration is really faster and cheaper, an additional and growing concern relates to the fairness or correctness of the result.

Almost all litigators and litigants have heard of stories of arbitration results that were outside of the range of what generally would be regarded as fair or correct. While arbitrary and capricious arbitration results may not occur with much frequency, the fact that it does occur on occasion creates deep and genuine concerns – particularly because arbitration awards are final and binding without any real opportunity for judicial review of errors of law or findings of fact. The stories and fears have reached the point that they have been noted in judicial opinions. The dissenter in *Crowell v. Downey Community Hosp. Found.* 115 Cal. App. 4th 730, 741-2 (2002), wrote:

> [O]ne of the worst positions an attorney can be in is to recommend binding arbitration and then have to explain to a bewildered (and angry) client an unexplainable adverse result that cannot be remedied. Anecdotal stories abound where an arbitrator has made an award contrary to the facts and the law.

Under California and federal law, review of an award resulting from a binding arbitration is extremely limited. *See Moncharsh v. Heily & Blase* 3 Cal. 4th 1, 6 (1992) ("an arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties"); *Crowell, supra,* 95 Cal. App. 4th at 738 (Federal Arbitration Act allows somewhat broader judicial review than the California Arbitration Act and allows a court to vacate or modify an award if it is "completely irrational" or exhibits a "manifest disregard of the law").

The rationale of *Moncharsh* is clear and set out in the California Supreme Court's opinion at 3 Cal. 4th at 9:

> The policy of the law … is to encourage persons who wish to avoid delays incident to a civil action to obtain an

> adjustment of their differences by a tribunal of their own choosing. … Expanding the availability of judicial review of such decisions 'would tend to deprive the parties of the arbitration agreement of the very advantages the process is intended to produce.'

The California case law supporting the finality of arbitration awards is so strong that at least one party who took an appeal challenging an arbitration award has been sanctioned for having filed a frivolous appeal. *See Pierotti v. Torian*, 81 Cal. App. 4th 17, 35 (2000) ("By filing a frivolous appeal from a judgment confirming an arbitration award, a party defeats the very purpose of the arbitration process").

But the emphasis on achieving faster, cheaper and final resolution of all disputes sometimes – particularly in significant disputes – creates a risk to the fairness or correctness of the decision that may go beyond what the parties are willing to accept. Many parties and their counsel have tried a variety of methods to try to achieve what they perceive to be a better balance between speed/efficiency/decreased costs, on the one hand, and fairness/correctness of the result, on the other hand. Some of those methods have been foreclosed by judicial decisions. At least one is still viable.

CAN CONSUMERS OF PRIVATE DISPUTE RESOLUTION SERVICES OBTAIN REAL REVIEW BY THE PUBLIC COURTS?

Current times have widely been described as the age of the consumer. Companies often compete to provide services that consumers want when and how we as consumers want them. Businesses are significant consumers of the services provided by the courts and by private ADR service providers. ADR service providers, such as the American Arbitration Association, JAMS and ADR Services, are very flexible in providing procedures consistent with the parties' needs. California courts have exhibited some significant commitment to attempting to provide the services needed by businesses to resolve their disputes by, for example, creating the Complex Case program that uses judges and procedural methods designed to address some of the unique characteristics of complex business disputes. *See* California Rules of Court, Rules 1800 *et seq.* But, thus far, there has been some resistance to allowing businesses to select some aspects of the public court system while opting out of others.

Strong evidence suggests that many business consumers of dispute services would prefer a dispute resolution method that would use the services of an

experienced retired judge or an experienced lawyer to decide the dispute as an arbitrator/referee/judge pro tem, but with appellate review by the public appellate courts.

EXPANDED JUDICIAL REVIEW

The most direct method to obtain expanded judicial review of arbitration decisions is to provide by contract that the parties agree that any court confirming the award should provide greater scrutiny than the minimum review provided by the Federal Arbitration Act or the California Arbitration Act.

In *Lapine Technology Corp. v. Kyocera Corp.*, 130 F.3d 884 (9th Cir. 1997), the parties entered into a joint venture to manufacture and market computer disk drives and included an arbitration clause that required detailed findings of fact and conclusions of law, and also provided that the U.S. District Court for the Northern District of California would vacate, modify or correct the award not only if appropriate under the Federal Arbitration Act, but also if the court found that "the arbitrators' findings of fact are not supported by substantial evidence, or … where the arbitrators' conclusions of law are erroneous." After an arbitration award against Kyocera, the District Court confirmed the award and ruled that "it could not review an arbitration award under a substantial evidence and error of law standard, even though that standard was part of the arbitration agreement made by the parties." *Id.* at 886. On appeal, the Ninth Circuit three-judge panel noted that the Federal Arbitration Act allowed vacation or modification of arbitration awards only on narrow grounds – if the award is "completely irrational" or exhibits a "manifest disregard of law." *Id.* at 888. The question was whether the parties could contract for "heightened judicial scrutiny" of arbitration awards. By a 2-1 vote the three-judge panel ruled that the parties' agreement should be enforced and reversed the District Court. Judge Kosinski wrote a concurring opinion that noted that he found the question presented to be closer than most. He wrote that the U.S. Supreme Court had noted that parties to an arbitration agreement could decide when, where and how the arbitration should be conducted, but none of its decisions "says that private parties may tell the federal courts how to conduct their business." Although he found no Congressional authorization for the federal courts to review arbitral awards under the standard that the parties had adopted, he concluded that "we must enforce the arbitration agreement according to its terms." As a characteristically colorful aside, he commented that "I would call the case differently if the agreement provided that the district judge would review the award by flipping a coin or studying the entrails of a dead fowl." *Id.* at 891.

But enhanced review of arbitral awards in the Ninth Circuit was short-lived. In August last year, the Ninth Circuit conducted an *en banc* review of the *Kyocera* case and held that "private parties have no power to determine the rules by which federal courts proceed, especially when Congress has explicitly prescribed those standards." *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*, 341 F.3d 987, 1000 (9th Cir. 2003). The *en banc* court, quoting an earlier decision, noted that there was "no authority explicitly empowering litigants to dictate how an Article III court must review an arbitration decision." *Id.* at 992.

Federal Circuits are split on whether the contracting parties can expand the standard of review of an arbitration award. In addition to the Ninth Circuit, the Second, Seventh, Eighth and Tenth Circuits refuse to allow the parties to obtain judicial review under standards that depart from the Federal Arbitration Act. *Hoeft III v. MVL Group, Inc.*, 343 F. 3d 57, 63 (2d Cir. 2003) (*dicta*); *Bowen v. Amoco Pipeline Co.*, 254 F. 3d 925, 937 (10th Cir. 2001); *Chicago Typographical Union No. 16 v. Chicago Sun Times, Inc.*, 935 F. 2d 1501 (7th Cir. 1991) (*dicta*); and *UHC Mgmt. Co., Inc. v. Computer Sciences. Corp.*, 148 F. 3d 992, 997-98 (8th Cir. 1998) (*dicta*). In contrast, the Third, Fourth and Fifth Circuits allow parties to contract for broader judicial review of arbitration awards. *Roadway Package Sys., Inc. v. Kayser*, 257 F. 3d 287, 292-93, n. 3 (3d Cir. 2001); *Syncor Int'l Corp. v. McLeland*, 120 F. 3d 262, 1997 WL 452245 (4th Cir. 1997) (unpublished); *Gateway Techs., Inc. v. MCI Telecomm. Corp.*, 64 F. 3d 993, 996-97, n. 3 (5th Cir. 1995); *see also New England Utilities v. Hydro-Quebec*, 10 F. Supp. 2d 53, 62-64 (D. Mass. 1998) (a district court within the First Circuit).

California appellate courts also have concluded that California courts cannot enforce arbitration contracts if the parties have attempted to "expand the jurisdiction of the court to review arbitration awards beyond that provided by statute…." *Crowell v. Downey Community Hosp. Found.*, 95 Cal. App. 4th 730, 732 (2002); *see also Oakland-Alameda County Coliseum Auth. v. CC Partners*, 101 Cal. App. 4th 635 (2002) (following the primary holding of *Crowell*, but affirming the confirmation of the arbitration award involved in the case by finding that invalid provision expanding the scope of judicial review could be severed under an unambiguous severance provision).

Like the federal courts, state courts are also split. In addition to California, Illinois, Michigan and North Dakota have concluded that the judicial review standard cannot be modified by the parties. *Chicago Southshore and S. Bend R. R. v. N. Ind. Commuter Transportation Dist.*, 682 N.E. 2d 156, 159 (Ill. Ct. App. 1997), *rev'd on other grounds*, 703 N.E. 2d 7 (Ill. 1998); *Dick v. Dick*, 534 N.W. 2d 185, 1991 (Mich. 1995); *John T. Jones Constr. Co. v. City of Grand Forks*, 665

N. W. 2d 698 (N.D. 2003). But Connecticut, Rhode Island and Texas have ruled that courts in those states must review according to the standard required by the contracting parties. *Maluszewski v. Allstate Ins. Co.,* 640 A.2d 129, 132-34 (Conn. Ct. App. 1994); *Bradford Dyeing Assoc. v. J. Stog Tech GmbH,* 765 A.2d 1226 (R.I. 2001) (*dicta*); *Tanox, Inc. v. Akin, Gump, Strauss, Hauer & Feld,* 105 S.W. 3d 244, 251 (Tex. Ct. App. 2003).

CONTRACTUAL WAIVER OF JURY TRIAL

Businesses often wish to have disputes resolved by someone who is an experienced neutral – whether public judge, private judge or experienced lawyer – because there is a fairly widely held view that juries are unpredictable and relatively unsophisticated in complex matters – particularly complex financial disputes. Again, the views have become so widely held that the courts have described them in their decisions. The California Court of Appeal, in *Woodside Homes v. Superior Court,* 107 Cal. App. 4th 723, 734-5 (2003), asked and answered the question about why arbitration and other procedures had become preferred by businesses:

> Why have provisions for arbitration or similar methods of dispute resolution outside the courtroom become so popular in contracts drawn up by the party who is overwhelmingly likely to be the defendant if a dispute arises? There are several possible reasons, some of which are perfectly neutral and operate evenhandedly; some may be stated more than one way, depending on one's philosophical bent. The “defendant in waiting” may believe that juries are unpredictable. It may believe that juries cannot be trusted with complicated cases, or that jurors may lose interest in a long case and return an ill-informed or arbitrary verdict. It may believe that juries are biased against “business.” It may believe that a trained neutral trier of fact will make a fairer decision.

The Court of Appeal added its overall explanation why businesses consistently prefer to avoid juries in consumer cases:

> Businesses prefer to have consumer cases heard by a neutral adjudicator because they expect that, year in and year out, the plaintiffs' recovery will be *less than juries would award.* (*Id.* at 735)

The most straight-forward manner in which to avoid a jury and to have the dispute resolved by an experienced judge or lawyer is to include in contracts a pre-dispute contractual waiver of a jury trial. *Trizec Properties, Inc. v. Superior Court,* 229 Cal.App.3d 1616 (1991) upheld the validity of pre-dispute contractual waiver of jury trials where the provision was contained in a clear, unambiguous commercial contract. There, the Court of Appeal commented on the desirability of such provisions:

> [I]n many commercial transactions advance assurance that any disputes that may arise will be subject to expeditious resolution in a court trial would best serve the needs of the contracting parties as well that of our overburdened judicial system. (*Id.* at 1619)

Very recently, in *Grafton Partners LP v. Superior Court (Pricewaterhouse Coopers)*, 115 Cal. App. 4th 700 (February 2004), the Court of Appeal, First Appellate District, Division Five, recognized that there were good policy arguments that could be made to support contractual predispute jury waivers and noted that "having an alternative to both jury trials and arbitration could prove beneficial." The Court of Appeal explained that:

> Agreements to resolve future disputes by court trial may alleviate fears of excessive jury awards while providing greater procedural protections than arbitration in many respects, including discovery, securing an impartial factfinder, and appeal, among others. … Thus, permitting predispute jury waivers, even in adhesive contracts, could be an attractive middle ground between jury trials, on the one hand, and arbitration, on the other. (*Id.* at 711)

Despite the policy arguments and the clear advantages to the parties to having a dispute decided by a judge sitting without a jury, *Grafton Partners* held that the California Constitution precluded any pre-dispute contractual jury trial waivers. The case involved a Pricewaterhouse Coopers engagement letter that contained language that: "In the unlikely event that differences concerning [PwC's] services or fees should arise … [the parties] agree not to demand a trial by jury." The Court of Appeal held that such *predispute* jury waivers in civil cases were not enforceable under California law even though the dispute was a commercial dispute between parties who knowingly entered into such a waiver in reliance on *Trizec Properties, Inc. v. Superior Court* (1991), which upheld such

waivers. The *Grafton Properties* court held that *Trizec* was wrongly decided. The court reasoned that the California Constitution allowed a jury trial waiver only if specifically authorized by the Legislature and that Code of Civil Procedure § 631 allowed a jury trial waiver only during the course of litigation. It also found that when the *Trizec* court upheld a predispute contractual jury waiver, that court had not considered or addressed the requirements of the California Constitution.

Courts nationwide are split on whether a pre-dispute contractual jury trial waiver is enforceable in a consumer setting, and some courts find the provisions invalid on ambiguity or unconscionability grounds. *See* "Contractual Jury Trial Waivers in State Civil Cases," 42 ALR5th 53. But, after the Court of Appeal opinion in *Grafton Partners*, there is a significant risk that California courts will refuse to enforce such predispute contractual jury trial waivers across the board. Very recently, on April 21, 2004, the California Supreme Court granted PricewaterhouseCoopers' petition for review in *Grafton Partners* and agreed to review the following issue: "Is a provision of a contract in which the parties agree in advance not to demand a jury trial in any action that may arise out of the contract enforceable or is such a contract provision unenforceable in light of the relevant California constitutional and statutory provisions relating to the waiver of trial by jury in civil cases? (See Cal. Const. art I, 16; Code Civ. Proc., sec. 631.)" As a result, the validity of contractual jury trial waivers under California law will remain uncertain for at least another year while the California Supreme Court considers and decides the issues presented in the *Grafton Partners* case.

JUDICIAL REFERENCE

While *Grafton Partners* rejects a predispute contractual waiver of a jury trial as inconsistent with the California Constitution, there is an alternative procedure – judicial reference – that achieves the most significant goals of a predispute contractual jury trial waiver and has additional advantages.

Under section 638 of the California Code of Civil Procedure, a referee may be appointed "upon the motion of a party to a written contract or lease that provides that any controversy arising therefrom shall be heard by a referee if the court finds a reference agreement exists between the parties." The referee may "hear and determine any or all of the issues in an action or proceeding, whether of fact or of law …" Under this procedure, the court appoints a referee agreed upon by the parties or nominated by the parties (Code Civ. Proc. § 640), thus providing the parties greater control over the critically important selection of the decisionmaker. In contrast, in a contractual jury trial waiver situation, the identity of the trial judge typically would be determined by the unilateral assignment by the

Presiding Judge – a decision that often is dependent upon which trial judge is available or has the lightest caseload at the time of the assignment.

Perhaps more importantly, the decision of a referee appointed under a consensual general reference under section 638 "must stand as a decision of the court" on which judgment may be entered (Code Civ. Proc. § 644) and is reviewable "in like manner as if made by the court" (Code Civ. Proc. § 645). *Woodside Homes v. Superior Court*, 107 Cal. App. 4th 723, 725 (2003) (the referee's statement of decision "may be entered as a judgment, *but* is also appealable.") Thus, the judicial reference option allows the selection of an experienced private judge or lawyer, but also provides for usual appellate review by the California appellate courts.

Although the costs associated with the use of a private judge to serve as a referee are greater than the inconsequential filing fee costs associated with the use of a public trial judge and public courtroom, many of the advantages of arbitration are available with judicial reference. The parties and the private judge can agree on how, when and where proceedings occur. In addition, one of the traditional advantages of arbitration – confidentiality – is available. A public courtroom generally must be open to the public. *NBC Subsidiary (KNBC-TV), Inc. v. Superior Court*, 20 Cal. 4th 1178 (1999). While not directly addressing the legality of confidential judicial reference proceedings, the Court of Appeal in *Woodside Homes, supra*, 107 Cal. App. 4th at 732, indicated that it saw "nothing unreasonable or prejudicial" about an agreement that provided that a judicial reference proceeding transcript be treated as confidential.

Yet another advantage of judicial reference relates to the looming judicial budgetary crisis in California. Some California legislators, judicial officers and bar leaders predict that the budgetary crisis may nearly close the courthouse to civil litigation. Because judicial reference utilizes private judges, parties that adopt judicial reference may be able to have their disputes adjudicated despite the anticipated adverse budgetary impacts on California's trial courts.

A predispute contract adopting a general reference under Code of Civil Procedure section 638 does not run afoul of the holding of *Grafton Partners* because that case held that the California Constitution was explicit that a jury trial could be waived only as provided by statute. Here, like arbitration, the Legislature specifically has authorized predispute judicial reference contracts. *See, Grafton Partners*, 115 Cal.App.4th at 711-713 (discussion of the California Arbitration Act as authorizing arbitration and the implicit waiver of the right to a jury trial).

CONCLUSION

In *Grafton Partners*, the Court of Appeal commented that PricewaterhouseCoopers had predicted that the decision would invalidate "thousands" of contractual jury trial waivers because such provisions were so widely used. *Id.* at 713. While that assertion probably is correct, there is a readily available alternative for those who negotiate and draft contracts that may give rise to disputes in California. A general reference under Code of Civil Procedure section 638 provides all of the benefits of a contractual jury trial waiver, including appellate court review, but also provides the additional benefits that the parties have greater control over the selection of their judge and greater control over how, where and when proceedings occur. Counsel who negotiate and draft contracts that contain dispute resolution provisions should seriously consider general reference as an alternative to the dispute resolution approaches that have recently been rejected by the courts – contractually expanded review of arbitration awards or contractual jury trial waivers.

February 2005

(This article first appeared in June 2004 edition of *Focus*, the newsletter of the Association of Corporate Counsel – America, San Francisco Bay Area Chapter, California, but has been supplemented to include additional authorities from courts across the nation.)